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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of)

Implementation of Sections of)
the Cable Television Consumer)
Protection and Competition Act)
of 1992)

Rate Regulation)
_____)

MM Docket No. 93-215

COMMENTS

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SUMMARY

Pursuant to the Cable Act of 1992, the Commission has established a framework for the regulation of cable television rates in the United States. Congress determined that where effective competition exists, cable rates should not be subject to regulation. In the absence of effective competition, the Commission has determined that a "benchmark and price cap" approach should be the primary regulatory regime.

BellSouth concurs with the Commission's determination that a "pure" price cap approach best meets the Congressional mandate to insure that rates for regulated cable services are reasonable. A "pure" price cap approach is an effective means of regulating companies in a market where competition is emerging. With the convergence of cable television and telecommunications technologies, it is particularly important that the regulatory regimes applied to these two industries provide proper incentives to maximize efficiency. BellSouth urges the Commission to establish competitive parity between cable operators and telecommunications providers by adopting a "pure" form of price cap regulation both for cable operators, in this proceeding, and for telecommunications providers in the upcoming comprehensive review of price cap regulation of local exchange carriers.

This proceeding is designed to develop a "cost of service" safety net to be used by cable operators that are not subject to effective competition, and who contend that rates that meet the primary "benchmark and price cap" requirements would not cover their costs. Such a regulatory regime should afford cable operators a reasonable opportunity to recover the cost of providing regulated cable services, while ensuring that customers of regulated cable services do not subsidize the provision of non-regulated cable services and non-cable services, such as telecommunications.

BellSouth believes that it is possible to craft a cost-of-service regulatory regime that minimizes regulatory burdens on cable operators while satisfying the Congressional mandate to protect cable subscribers and promote competition. The Commission should resist the temptation simply to engraft into cable regulation the traditional cost-of-service regulation applied to telecommunications companies. Instead, the Commission should use this proceeding to take a fresh look at the traditional regulatory process and to prune away aspects of that process that do not produce benefits that exceed their costs. The Commission should look for ways to streamline cost-of-service regulation for cable operators, and then achieve competitive parity by eliminating unnecessary regulation now applied to telecommunications carriers.

In these Comments, BellSouth offers specific suggestions for implementing cost-of-service regulation in a way that minimizes regulatory burdens on cable operators, while satisfying the Congressional mandate to protect cable subscribers against unreasonable rates and cable competitors against cross-subsidy.

BellSouth recommends that the Commission rely upon GAAP accounting whenever possible in its regulatory regime for cable operators. This will provide consistency between a cable operator's regulatory and financial books, and will ease the transition to a fully competitive marketplace.

A major aspect of cost-of-service regulation is the authorized rate of return. The authorized rate of return should measure the cost of capital of an operation in a manner that takes in to account the business and financial risks attendant to that business. Unfortunately, there is little information in the present record that provides a basis to establish an authorized rate of return for regulated cable services. Therefore, BellSouth recommends that the Commission adopt an interim rate of return for cable operators and establish a separate phase of this proceeding to examine in more detail cost of capital issues relevant to regulated cable services.

BellSouth recommends that the Commission adopt a streamlined approach to depreciation regulation. The Commission should prescribe the use of the straight-line,

remaining life method but allow cable operators to estimate the remaining life of their assets.

The Commission also seeks comment in this proceeding regarding the necessity for a productivity offset in the price cap formula applied to regulated cable services. BellSouth supports the concept of a productivity offset for an industry that has a cost structure that allows it to achieve productivity greater than that achieved in the economy as a whole. However, there is little factual information in this record, at least at this stage of the proceeding, that would permit the Commission to evaluate either the historical or potential productivity of the cable industry. BellSouth therefore recommends that the Commission require cable operators to submit the information necessary for the Commission and other interested parties to examine cable productivity issues in a comprehensive way. In the interim, the Commission should adopt a productivity offset similar to that applied to telecommunications carriers.

Finally, BellSouth generally supports the Commission's proposals to collect additional information to satisfy the requirements of the Cable Act of 1992. In this regard, BellSouth offers several specific suggestions, including a recommendation that the Commission require cable companies to file informational tariffs for both interstate and

intrastate communication services as a complementary
cost-of-service safeguard.

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COMMENTS

BellSouth Telecommunications, Inc. ("BellSouth") hereby offers its comments in the captioned proceeding as requested by the Notice of Proposed Rulemaking ("NPRM"), FCC 93-353, released July 16, 1993.

I. Introduction

On May 3, 1993, the Commission released a Report and Order and Further Notice of Proposed Rulemaking, FCC 93-177, in MM Docket No. 92-266 ("Report and Order").¹ In the Report and Order, the Commission established the basic regulatory framework for implementing the cable television rate regulation provisions of the Cable Act of 1992.² The act requires regulation of cable television services, other than premium channels and pay-per-view, provided by cable systems not subject to effective competition. In the Report and Order, the Commission adopted the following hierarchy to

¹58 FR 29736 (May 21, 1993).

²Pub. L. No. 102-385, §§ 3, 9, 14, 106 Stat. 1460 (1992).

ensure reasonable rates for regulated cable services³:

(1) if there is "effective competition", no regulation of rates; (2) in the absence of effective competition, the primary regulatory method shall be a "benchmark and price cap" approach, and (3) if "the benchmark and price cap" approach does not afford cable operators an opportunity to recover the reasonable cost of providing regulated cable services, the cable operator may justify higher rates based on costs.⁴

Thus, the rules under consideration in this proceeding will have limited application: they will not apply to cable systems subject to effective competition; they will not apply to any services offered by cable systems that elect to be regulated under the primary "benchmark and price cap" regulatory approach; they will not apply to premium "per

³The Cable Act of 1992 defines a "basic services tier" that includes rebroadcast local signals subject to statutory carriage requirements, any programming required by the franchise authority to be provided to cable subscribers, and any other broadcast signal provided to subscribers except secondarily transmitted "superstation" signals carried by the cable company beyond the local service area of such station. See 47 U.S.C. § 543(b)(7)(A). "Cable programming service" is defined as "any video programming provided over a cable system, regardless of service tier, including installation or rental of equipment used for the receipt of such video programming, other than (A) video programming carried on the basic service tier, and (B) video programming offered on a per channel or per program basis." See 47 C.F.R. § 543(1)(2). BellSouth will refer to both the basic services tier and cable programming services as "regulated cable services" in these comments, except where a distinction between these tiers is required by the context.

⁴NPRM at paras. 4-5.

channel" and "pay per view" services offered by cable systems electing cost-of-service regulation, and they will not apply to non-cable services, such as two-way interactive services⁵ and telecommunications services offered over cable systems. The limited application of the rules, the fact that cable operators will be providing both regulated and nonregulated services, and the need for competitive parity all influence the regulatory requirements that are necessary to apply cost-of-service regulation to cable companies. For the convenience of the Commission BellSouth will address the issues related to cost-of-service regulation for regulated cable services in the order in which they appear in the NPRM.

II. Regulatory Goals

Cable television and telecommunications services and technologies are converging. The Commission should structure its regulation of the two industries to afford competitive parity whenever possible. As will be clear from these comments, however, BellSouth does not endorse the application of unnecessary and inefficient regulation to cable operators simply because such regulation is currently applied to local exchange carriers ("LECs"). BellSouth recommended, and in the Report and Order the Commission

⁵The Cable Act defines "cable service" as including only the "one-way transmission to subscribers" of video programming and other programming services. 47 U.S.C. § 522(5). Therefore, by definition, all two-way video and interactive services are not "cable services".

adopted, a "pure" price cap plan for the cable industry.⁶ For those cable companies, however, that seek to charge prices higher than those authorized under the cable price cap plan, BellSouth recommends in this proceeding the minimum requirements that are necessary to make cost-of-service regulation meaningful and effective.

As the Commission has previously recognized when it adopted price cap regulation for AT&T and the LECs, where the primary regulatory approach is price cap regulation, a carrier seeking to justify "above cap" rates must meet a difficult and rigorous standard.⁷ The incentive structure of price cap regulation is destroyed if carriers can "game" the system by easily switching from price cap to cost-of-service regulation depending on which promises higher earnings. This is equally true for cable regulation. The initial benchmark rates for cable price cap regulation were based on unregulated rates charged by cable operators subject to effective competition. The Commission begins

⁶BellSouth will urge the Commission to move towards regulatory parity between cable companies and LECs by adopting a "pure" price cap for the LECs during the comprehensive review of the LEC price cap plan scheduled to begin in a few months.

⁷In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Report and Order and Second Further Notice of Proposed Rulemaking, FCC No. 89-91, released April 17, 1989 ("AT&T Price Cap Order") at paras. 487-489. See also, In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, FCC Docket No. 87-313, Second Report and Order, FCC No. 90-314, released October 4, 1990 ("LEC Price Cap Order") at paras. 300-304.

with a presumption that such rates are reasonable.⁸ Further, under the price cap plan adopted for cable companies in the Report and Order, cable prices are permitted to rise with inflation.⁹ In addition, large segments of cable operator costs are treated as "exogenous" and are permitted to be passed directly through to subscribers. It is highly unlikely that rates set in such a fashion will be unreasonably low. Nevertheless, BellSouth believes that it is appropriate to grant above cap rates to cable operators when the operator can demonstrate that higher rates are necessary to permit the operator to attract capital and to continue to operate.¹⁰

The cost-of-service standards must also provide adequate assurance that cable operators electing this form of regulation cannot shift costs from discretionary services, such as per channel and pay per view services, and competitive services, such as two-way interactive services and telecommunications, to regulated cable services. To meet this objective and to satisfy the express requirements of the Cable Act, the cost-of-service formula should require accounting by function and reasonable allocation of costs between the various cost categories proposed in the NPRM.

⁸NPRM at para. 10.

⁹BellSouth discusses the need for a productivity offset in the cable price cap plan in Section V of these comments.

¹⁰NPRM at para. 13. Cf. LEC Price Cap Order, para. 304.

BellSouth will discuss accounting and cost allocation requirements in more detail in Section III C of these comments.

III. Regulatory Requirements

A. Procedures for Cost-of-Service Showings

The NPRM proposes to limit cost-of-service filings by requiring that once a cost-of-service filing has been evaluated by the regulator, another filing applicable to that tier not be permitted for one year.¹¹ BellSouth concurs. Such a requirement will eliminate the problem of "pancaked" filings. In the absence of extraordinary events, it is unlikely that costs will change dramatically during the one year blackout period. If such an extraordinary event should occur, the Commission can consider a waiver request by a cable operator accompanied by a showing of good cause to justify the waiver.

BellSouth also agrees with the proposal in the NPRM to require a uniform presentation of costs and supporting data on an FCC prescribed form.¹² The form adopted must provide sufficient data to permit interested parties to evaluate the reasonableness of allocation of total costs between tiers for regulated cable service and between regulated and nonregulated cable services provided by the cable operator.

¹¹NPRM at para. 17.

¹²NPRM at para. 19.

The form should also provide data on the allocation of costs to non-cable services, such as two-way interactive services and telecommunications. Such data is necessary to determine whether non-cable services are receiving a reasonable allocation of joint and common costs.

B. Cost-of-Service Standards

The traditional cost-of-service formulation permits a regulated entity to recover its operating costs and taxes and to earn a reasonable return on investment. The NPRM proposes to utilize the traditional cost-of-service formulation "as the overarching standard to govern cost based rates for cable service."¹³ BellSouth concurs that the traditional cost-of-service formulation provides a reasonable starting point for the regulation of regulated cable services. BellSouth identifies below specific exceptions to the traditional approach that may be considered by the Commission to be appropriate for regulated cable services.

1. Annual Expenses

The NPRM proposes that a cost-of-service showing permit the recovery of operating expenses, depreciation and taxes as annual expenses of providing cable service. It also proposes to prohibit the recovery through regulated cable rates of expenses unrelated to the provision of regulated

¹³NPRM at para. 20.

cable services.¹⁴ The Commission's Rules already provide that costs unrelated to the provision of regulated cable services shall be excluded in the development of rates for regulated cable services.¹⁵ Furthermore, the Cable Act requires that the Commission provide for reasonable allocation of joint and common costs between regulated cable services and unregulated services.¹⁶ BellSouth will discuss this issue in more detail in Section III C of these comments.

(a) Operating Expenses

The NPRM tentatively concludes that operating expenses incurred by cable operators should include plant specific costs, plant non-specific costs, customer operations and corporate operations.¹⁷ BellSouth agrees that these are the major cost categories that should be reflected in a cost-of-service showing.

¹⁴NPRM at para. 23.

¹⁵47 U.S.C. § 76.924(g).

¹⁶See 47 U.S.C. Sec. 543(b)(2)(iii) and (v). This point is made explicit in the Conference Report (Report No. 102-862) adopted September 14, 1992 in connection with the passage of the Cable Act of 1992. The Conference report states, at page 63: "The language concerning joint and common costs is clarified to ensure that joint and common costs are recovered in the rates of all cable services, not only the rates for basic cable service, as determined by the Commission. . . . The regulated, basic tier must not be permitted to serve as the base that allows for marginal pricing of unregulated services."

¹⁷NPRM at para. 24.

The NPRM proposes to treat programming expenses as a recoverable operating expense, but not an element of rate base. It requests comment on whether the Commission should permit a profit or mark-up on programming expenses in the development of cost based rates to provide an incentive for cable operators to provide expanded programming.¹⁸

Under the primary "benchmark and price cap" regulatory regime applicable to cable, cable operators have the incentive to expand programming to increase penetration rates and thus revenue. As competition expands for the delivery of programming by alternate suppliers, cable operators will face increasing demand for expanded programming to remain competitive to retain market share.

Cable operators that consistently use a cost-of-service showing will have less incentive to provide expanded programming. BellSouth does not object to the Commission permitting such carriers a reasonable mark up on the cost of expanded programming. Providing cable operators subject to cost-of-service regulation with an incentive to acquire new programming would foster the development of new programming and new programming sources.

The NPRM proposes to disallow certain special expenses, such as lobbying expenses; charitable contributions; membership fees and dues in social, service and recreational clubs, and fines paid on account of violations of statutes

¹⁸NPRM at footnote 24.

and rules.¹⁹ The Commission currently excludes these costs from cost-of-service rates for interstate telephone service.

A reasonable amount of such costs are incurred by most businesses operating in competitive markets and are recovered through the prices charged for the services of such enterprises. Therefore, BellSouth disagrees with the Commission's rationale for excluding all such costs in the ratemaking process. Rather than exclude these costs from cable cost-of-service showings, the Commission should permit a reasonable amount of such costs to be recognized in ratemaking by both cable operators and telephone companies. If, however, the Commission continues to exclude such costs from telephone service rates, the same rationale would require the exclusion of such costs from rates for regulated cable services.

The Commission also seeks comment on which costs should be expensed and which should be capitalized.²⁰ For the sake of ease of administration, BellSouth recommends that the Commission simply require that cable operators follow GAAP in connection with the capital/expense classification.

(b) Depreciation

The NPRM seeks comment on whether the Commission should prescribe the depreciation practices of cable operators.²¹

¹⁹NPRM at para. 24 and footnote 25.

²⁰NPRM at para. 24.

²¹NPRM at paras. 25-29.

As a practical matter, the Commission cannot implement meaningful cost-of-service regulation without some control over depreciation, since depreciation expense is a major component of the cost of providing cable service.²² The real issue is whether the Commission can devise a means of regulating cable operators' depreciation expense without a laborious process such as that currently employed in telecommunications regulation.

The Commission should approach depreciation regulation with the realization that most cable operators can be expected to utilize the primary "benchmark and price cap" regulatory regime. As to such cable operators, there is no direct link between depreciation practices and the rates for regulated cable services. Depreciation practices become a significant regulatory issue only when a cable operator seeks to charge above benchmark rates pursuant to a cost-of-service showing. Unfortunately, there is no way to segregate "price cap" cable operators from "cost of service" cable operators, since any given cable operator potentially can attempt a cost-of-service showing. BellSouth therefore recommends that the Commission prescribe basic depreciation

²²The suggestion in paragraph 29 of the NPRM that the Commission simply monitor depreciation practices is inadequate if cost of service regulation is to be effective. However, the Commission can monitor depreciation practices of "benchmark and price cap" cable operators to provide useful information in evaluating the reasonableness of the depreciation expense of cost of service cable operators, as discussed below.

practices applicable to all cable operators except those determined to be subject to effective competition.

BellSouth urges the Commission, however, to avoid the detailed prescription of depreciation rates currently applied to the telecommunications industry.

The Commission should permit the cable operator to estimate the remaining useful life of its plant. The Commission can review these estimates for consistency both over time and with estimates provided by the cable operator for other purposes, such as Securities and Exchange Commission financial statements. The Commission can also gather depreciation information from cable operators that utilize the "benchmark and price cap" regulatory regime. If the depreciation information submitted in a cost-of-service filing varies appreciably from that being used by price cap cable operators, the Commission can challenge, and if necessary adjust, the depreciation expense claimed in the cost-of-service proceeding.

BellSouth believes that the Commission can achieve its fundamental regulatory responsibilities under the Cable Act of 1992 by prescribing the use of the straight line, remaining life methodology applied to book value of assets by all cable operators not subject to effective competition. This will ensure actual recovery of the book value of the assets and avoid over- or under-recovery from subscribers. If the Commission permits cable operators to estimate the

remaining lives of their plant, as BellSouth recommends, this methodology will not result in the deferral of capital recovery and the development of reserve deficiencies that currently exist in the telecommunications industry.²³ For ease of administration, the Commission should assume that the net salvage value is zero, i.e., that gross salvage is offset by the cost of removal. This assumption will eliminate some of the most time-consuming aspects of depreciation regulation of the telecommunications industry without significant impact on rates for regulated cable services.²⁴

(c) Taxes

The NPRM proposes to allow taxes incurred in the provision of regulated cable services in determining a cable operator's annual expense. BellSouth concurs. However, 47 U.S.C. § 543(b)(2)(C)(5) requires that taxes applicable to the entire entity be reasonably and properly allocated between regulated cable services and other services offered by the cable operator. Paragraph 30 of the NPRM states that "all state and federal taxes on the provision of cable

²³These suggestions are consistent with BellSouth's recommendations for the regulation of depreciation rates for the telecommunications industry in CC Docket No. 92-296, Simplification of the Depreciation Prescription Process.

²⁴Such an approach is much easier in the context of cable regulation than in telecommunications because cable depreciation practices have not previously been regulated. Therefore, unlike the telecommunications industry, there are no historical imbalances and potential inequities to address.

service and "... income taxes attributable to the provision of regulated cable service" will be allowed in connection with a cost-of-service showing. If the NPRM intended this wording to draw a distinction between income taxes and other taxes, and to suggest that other taxes will not be allocated between regulated cable services and other nonregulated services, this outcome is precluded by the Cable Act of 1992.²⁵ Regulated cable service customers can lawfully only be charged a "reasonably and properly allocable" portion of the total taxes borne by the cable operator.²⁶ BellSouth urges the commission to clarify that these other taxes are common costs subject to the cost allocation requirements of 47 C.F.R. § 76.924(f) of the Rules.

2. Ratebase

The NPRM proposes to include in the cable ratebase the traditional categories of plant in service, plant held for future use within a reasonable period of time, and working capital.²⁷ BellSouth agrees with these basic inputs to ratebase. Specific issues regarding the development of ratebase are discussed below.

²⁵See footnote 16, supra, discussing the joint and common cost requirements of the Cable Act of 1992.

²⁶The Conference Report accompanying the Cable Act of 1992 expressly addresses this issue at page 63.

²⁷NPRM at para. 31.

(a) Plant in Service

The NPRM addresses the myriad concerns that are raised when a going concern that has been unregulated is subjected to cost-of-service regulation. Nowhere are those concerns more difficult than in the valuation of plant in service for purposes of establishing a ratebase. While the Commission is under a Congressional mandate to protect the interest of subscribers to regulated cable services, it also must afford cable operators the opportunity to earn a reasonable profit.²⁸

The NPRM concludes that the Commission should employ the traditional ratebase construct and apply the "used and useful and prudent investment standards to the original construction cost of the assets dedicated to service."²⁹ Although this standard has been applied to traditional public utilities since the 1920s, it may be inappropriate for an industry being brought under cost-of-service regulation for the first time. Such firms have been subject to GAAP accounting, which requires that entities book assets at the price paid in arms length transactions with third parties. When a cable system is purchased from a non-affiliate, the assets should be recorded at fair market

²⁸The Conference Report expressly recognizes this point at page 63: "The conferees agree that the cable operators are entitled to earn a reasonable profit." Of course, cable operators also enjoy a constitutional protection against confiscation.

²⁹NPRM at para. 32.

value. Costs in excess of fair market value of the assets purchased should be recorded as "goodwill".

BellSouth recommends that the Commission require cable operators to report the cost of purchased cable systems based on GAAP. This would permit a cable operator that has purchased cable assets to value those assets on the books at fair market value at the time of the purchase. The portion of the purchase price in excess of fair market value, if any, would be classified as "goodwill". BellSouth recommends that the Commission include in ratebase the book value of plant in service, recorded in accordance with GAAP. BellSouth also recommends that the Commission exclude "goodwill" from ratebase but allow the amortization of "goodwill" over the remaining useful life of the assets.³⁰ Other costs, of the type described in footnote 44 of the NPRM, should be disallowed for ratemaking purposes. This approach would provide cable operators with a reasonable opportunity to recover their investment in cable systems.

BellSouth recommends that the Commission permit the inclusion of plant under construction in ratebase with no capitalization of interest during construction unless the amounts that would be capitalized are material.³¹ This approach is consistent with GAAP and will simplify the

³⁰NPRM at para. 41.

³¹NPRM at para. 42.

accounting for plant under construction with no significant impact on subscribers to regulated cable service.

Questions regarding excess capacity, cost overruns and premature abandonments³² should be addressed on a case by case basis in connection with a cost-of-service review. The Commission should apply the traditional "prudent investment" and "used and useful" concepts to determine whether disallowances are required in individual cases. BellSouth also believes that the Commission should monitor industry practices with regard to these problems and impose regulatory requirements later if these problems appear to be endemic among cable operators.

(b) Working Capital

As the NPRM recognizes, lead/lag studies to determine working capital requirements for inclusion in cost-of-service analyses are arduous.³³ BellSouth believes that it would be unreasonable to impose a lead/lag study requirement as part of a cost-of-service showing. BellSouth recommends that individual operators use a balance sheet approach to determine working capital.³⁴ This approach has the advantage of determining working capital actually employed by an individual cable operator without requiring

³²NPRM at para. 43.

³³NPRM at paras. 44-45.

³⁴The balance sheet approach determines the average difference between current assets and current liabilities of the cable operator.

costly and complex studies. BellSouth believes that this approach will be fair to ratepayers, since it will approximate the results of more complex analysis. Alternatively, the Commission could adopt a simple formula approach like the one utilized in regulating small telephone companies. In any event, there is no need for the Commission to require complex and costly lead/lag studies to determine working capital requirements for cable cost-of-service showings.

3. Rate of Return

The Commission's approach to the rate of return issue in the NPRM is exceedingly ambitious.³⁵ The Commission seeks to resolve both methodology issues and prescription issues in this proceeding. By contrast, the Commission has conducted three separate methodology proceedings for the telecommunications industry since 1984, and is still considering methods and procedures to perform rate of return prescriptions in the telecommunications industry.

Even if the Commission had a prescribed methodology available, similar to that contained in Part 65 of the Rules for telecommunications carriers, a full-blown prescription proceeding could take up to a year to complete. The Commission would have to analyze the business and financial risks associated with the provision of regulated cable services. Recognizing the fact that the onset of

³⁵NPRM at paras. 46-56.